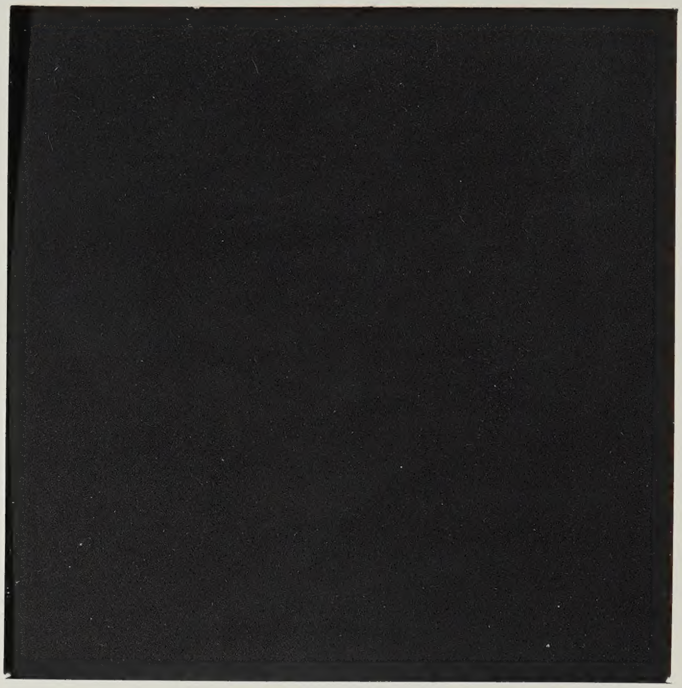
SMALL BUSINESS ADVOCACY
REPORT NO. 3

EXPANDING ONTARIO'S SMALL BUSINESS DEVELOPMENT CORPORATIONS PROGRAM TO BUSINESS SERVICES

May, 1985

MINISTRY OF INDUSTRY,
TRADE AND
TECHNOLOGY
ONTARIO



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May, 1985

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T A B L E   O F   C O N T E N T S

EXECUTIVE SUMMARY

Issue:

- To improve the access of small business in Ontario to equity capital through the Small Business Development Corporations (SBDC) program.

Background:

- SBDC is the principal instrument within provincial jurisdiction for improving the equity financing climate for Ontario small business.

- The SBDC program is currently restricted to firms in the manufacturing, research and development, tourism and book publishing fields.

- Business organizations, financial institutions, expert advisors and venture capitalists consulted by MIT favour broadening eligibility under SBDC to a wider range of small firms in the service sector.

Findings:

- SBDC is a very effective program, well-liked by business and successful in stimulating incremental investment in small business.

- SBDC has assisted in placement of investments averaging $185,000 in the designated areas of manufacturing, research and development, tourism and book publishing.

- New business formation, expansion, and job creation in service

- Because the service sector is so dynamic, the expected job creation benefits of improved access to equity through extension of SBDC to small service sector firms would be 2.8 times greater than the existing combination of manufacturing and other eligible businesses. The greatest job creation benefits of all will come from the business services area (See Appendix 3).

- Service sector performance has also exceeded manufacturing in share of output and capital expenditure over the past decade.

- There is a persistent deficiency in access to equity capital among small firms, particularly for start-ups, young firms and companies not yet ready for public issue of shares.

- The Ministry of Revenue's matching of SBDC investors with small business investment opportunities is a valuable service to Ontario entrepreneurs.

Recommendations:

1. That top priority for extension of eligibility under Ontario's SBDC program be given to Ontario's 15,000 business services firms (See Appendix 4).

2. That the Ministry of Revenue expand its existing Match-up Service to introduce appropriate SBDC investors and small business owners and emphasize smaller placements of equity.

MINISTRY OF INDUSTRY AND TRADE

EXPANDING ONTARIO'S SBDC PROGRAM TO BUSINESS SERVICES

I. INTRODUCTION

The Small Business Development Corporations (SBDC) program initiated in July 1979 has provided much needed sources of equity from private sources to small firms in Ontario. Recipients have been provided with the means to start-up, expand or revitalize their companies, enhancing economic growth and establishing and saving jobs. The success of SBDC is demonstrated by the fact that most other provinces have set up similar structures to place equity in small firms.

In its February 1984 report to the Ontario Ministry of Treasury and Economics, Clarkson Gordon concluded the SBDC program was "successfully meeting its objectives of supporting small business in Ontario through the encouragement of new equity investment by the private sector. The program is well received by participants, is lauded by major small business organizations, and the efficient administration by the Ministry of Revenue contributes to its success."[1]

The Clarkson Gordon report goes further. Compared with other equity incentive programs in Canada, the Ontario SBDC was judged "the most successful of its kind".[2] The program is reaching its target group; small firms unable to obtain government-assisted equity funding elsewhere. "In a period of budgetary restraint, the SBDC program objectives and structure are particularly appropriate".[3]

The Clarkson Gordon opinion on SBDC is shared by business associations and professionals. Participants at the January 31, 1985 consultation on equity financing, hosted by MIT's Small Business Advocacy section, agreed that SBDC was a popular vehicle meeting small business needs. Participants said that SBDC should be continued, enriched and restructured by broadening eligibility to sectors beyond manufacturing, tourism, research and development and book publishing. They suggested measures such as reducing minimum capitalization levels from $100,000 to $50,000 to encourage placements of smaller amounts of equity SBDC was regarded as Ontario's best equity financing vehicle. It was seen as the sole tool available to the Province providing direct equity infusions into small firms from private sources.[4]

This paper addresses the recommendation which emerged from MIT's consultative process that SBDC should be expanded to include additional types of businesses. The next section examines the performance of the service sector with special attention to business services as a potential area for inclusion in SBDC. The third section of the paper discusses the equity needs of small firms and the particular needs of the service sector. The fourth section assesses the impact to the Ontario economy of broadening access to the SBDC program.

II. SERVICE SECTOR PERFORMANCE

As a whole, North America has experienced growth in the number of starting firms and in entrepreneurial initiatives in the 1980s. Despite historically high interest rates, high inflation levels, and shortages of qualified workers business formations held consistent and actually increased in some jurisdictions.

In Ontario, for example, about 80,000 new firms register annually of which most are small enterprises. Small firms are increasingly headed by youths and women. These firms have maintained a labour intensive approach and have been, as a result, responsible for the overwhelming majority of new jobs created in the economy. New business formations in the manufacturing sector have continued but formations and attendant job creation in the service sector far outnumber those in goods-producing businesses.

Service Sector Performance in Canada

The service sector in Canada has, since the mid-1970s, demonstrated positive growth in number of firms and in the creation of new jobs. David Birch of the Massachusetts Institute of Technology has assessed sectoral job growth through a longitudinal study of Dun and Bradstreet data. Firms within the Dun and Bradstreet data base created 1,121,592 jobs between 1974 and 1982.[5] As Table 1 shows, about 55% of net new jobs were created by firms with less than 20 employees. Slightly over 63% of net new jobs were

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5 DRIE, "Job Creation Process in Canada", undertaken with

created by firms with fewer than 50 employees. Large enterprises with 500 or more employees were also major contributors to net employment growth at 39%. Medium-sized firms, however, showed a small net loss in employment between 1974 and 1982.[6]

TABLE 1

PERCENTAGE OF NET EMPLOYMENT CHANGE BY FIRM SIZE AND INDUSTRY CANADA 1974 - 1982

Number of Employees

Selected Sectors	0-19	20-49	50-99	100-199	200-499	500+	Total
	(Per Cent)						
Manufacturing	7.4	1.7	(1.2)	(2.3)	(3.1)	7.7	10.0
Trade	14.0	1.0	(0.4)	(0.7)	(0.5)	7.9	21.4
Construction	6.6	(9.5)	(0.8)	(0.9)	(0.1)	0.6	5.0
Finance	4.1	0.6	0.3	0.1	0.3	4.6	10.0
Services	17.1	4.9	2.7	1.9	1.4	9.4	37.4
Total:	54.7	8.5	0.6	(1.8)	(1.4)	39.4	100.0*

* Total does not add to 100% vertically as only selected sectors are shown.

Source: DRIE, "Job Creation Process in Canada" undertaken with assistance by David Birch, October 1984, p.13

Considering the performance of various sectors, Birch found that services and trade were the largest contributors of jobs at 37% and 21% respectively. Manufacturing and financial services were third largest net contributors to employment growth, each accounting for 10% of the increase. In services and trade it was again the smallest enterprises which generated most new jobs. For finance and manufacturing sectors large companies made the largest net contribution.

6 DRIE, "Job Creation Process in Canada", undertaken with

Table 2 provides the net percentage change in employment by sector in the 1974 to 1982 period.

TABLE 2

COMPONENTS OF NET EMPLOYMENT CHANGE BY INDUSTRY
CANADA 1974 - 1982

Industry	Births	Deaths	Expansion	Contraction	Net Change
			(Per Cent)		
Agriculture	54.5	(24.6)	29.1	(14.5)	44.5
Forestry	47.7	(2.1)	21.7	(18.0)	19.2
Fishing	53.0	(17.3)	26.4	(24.8)	37.2
Mines	75.7	(31.8)	19.4	(10.8)	52.6
Manufacturing	30.7	(28.6)	17.7	(12.5)	7.3
Construction	47.2	(33.2)	20.8	(20.1)	14.8
Transportation	45.8	(21.3)	29.3	(17.2)	36.6
Trade	44.7	(30.8)	19.1	(11.4)	21.7
Finance	68.7	(28.5)	24.8	(15.4)	49.6
Services	61.5	(24.8)	25.0	(10.7)	51.0

Source: DRIE, "Job Creation Process in Canada" undertaken with assistance by David Birch, October 1984, p. 17.

Overall, births have contributed by far the largest proportion of new jobs, over twice that attributed to expansions. The job creation input of new companies was particularly significant in mining (76%), finance (69%) and service (62%) sectors. Manufacturing was the only sector where employment gains due to start-ups of new companies was below average (31%).

The Birch analysis concluded that the service sector had been by far the largest net contributor to new employment from 1974 to 1982. Of the major service sector groups shown in Figure 1, business services has shown the most dynamic growth over the analysis period. Only two of the eleven service industries surveyed by Birch had job creation performance inferior to the manufacturing groups.

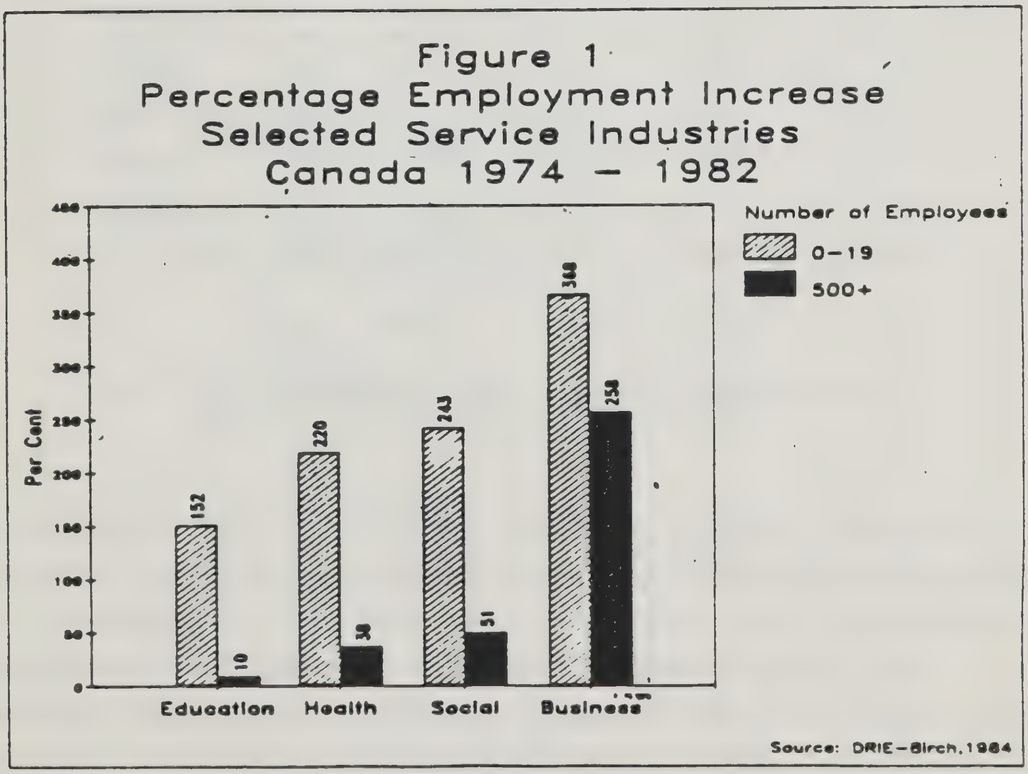


Table 3 demonstrates the job creation impact of births and expansion within the service sector. By a wide margin, the sector's growth was dominated by business services from 1974 to 1982.

TABLE 3

COMPONENTS OF NET EMPLOYMENT CHANGE BY SERVICE INDUSTRY
CANADA 1974 - 1982

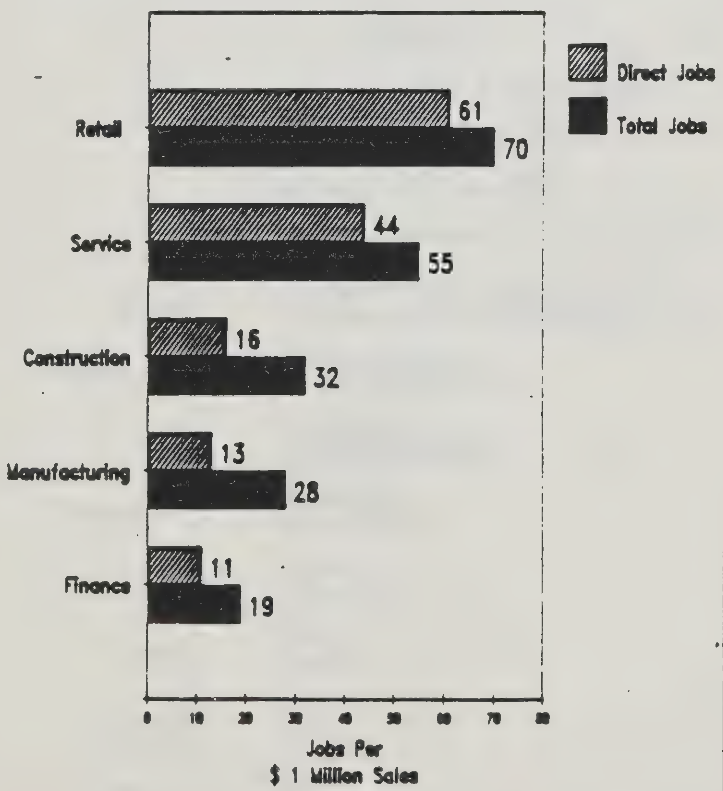
Services	Births	Deaths	Expansion	Contraction	Net Change
			(Per Cent)		
Education	15.2	(8.9)	23.5	(11.6)	18.2
Museums	62.0	(8.4)	50.7	(2.9)	101.3
Health	23.1	(5.6)	31.5	(5.1)	44.0
Social	96.6	(20.0)	21.0	(7.4)	90.2
Religion	54.1	(4.5)	36.9	(13.5)	72.9
Amusement and Recreation	86.5	(28.2)	28.5	(12.7)	74.1
Business	157.7	(35.4)	50.0	(12.8)	159.4
Professional	97.3	(30.1)	31.4	(11.3)	87.3
Personal	39.4	(31.0)	12.4	(14.1)	6.7
Accommodation	76.4	(33.6)	20.7	(11.4)	52.0
Miscellaneous	60.1	(29.4)	23.1	(12.1)	41.7
Total	61.5	(24.8)	15.0	(10.7)	51.0

Source: DRIE, "Job Creation Process in Canada", undertaken with assistance by David Birch, October 1984, p.29.

The greatest net percentage increase in jobs occurred in business services. Overall, business services experienced a net increase of 159% from 1974 to 1982. New formations represented a growth of 158% with expansions at 50%. Business deaths were decidely less at 35% and contractions were 13%. The net difference between births and deaths for business services was 122%. This compares to net differences of 77% for social services and 67% for professional services. Business services experienced the highest rate of births, second highest levels of expansion and moderate failures and contractions compared to the total net change experienced in the service sector.

The business services sector in Canada grew from 23,000 firms in 1976 to about 42,000 firms in 1982. Service industries provide more jobs per dollar of revenue than other sectors, particularly manufacturing. According to Statistics Canada, it takes approximately $75,000 to create one direct new job in manufacturing; service firms create a direct new job for $22,500 in sales. Figure 2 shows that the service sector provided 55 new jobs for every million dollars of new sales compared to 70 in retail trade and 28 in manufacturing.

Figure 2
Job Creation by Industry, Canada 1978



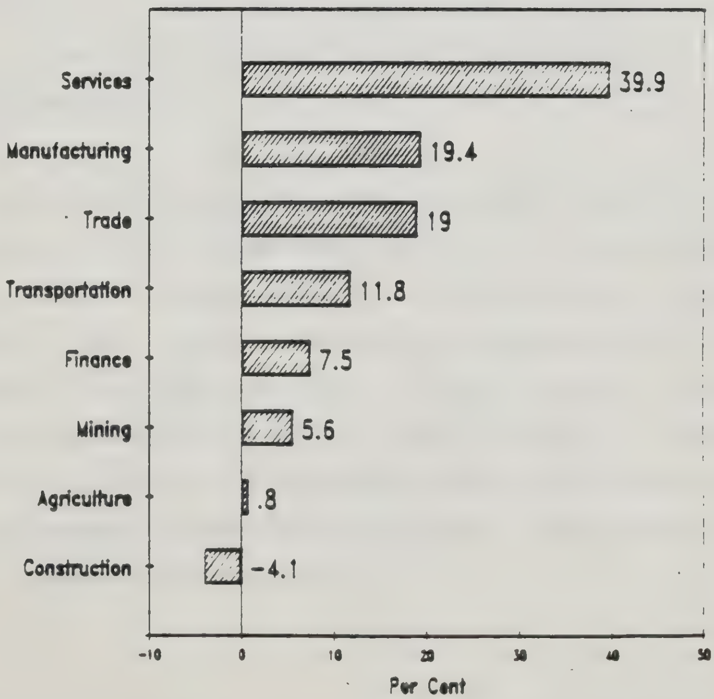
Source: Statistics Canada

In terms of relative employment growth, business and personal services and financial services were the strongest overall performers over the period 1974 to 1982. Business and personal services were the fastest growing industries in

Service Sector Performance in Ontario

From 1974 to 1982, Birch found that Ontario made the largest contribution to new jobs (26.0%) followed by Alberta (25.6%). As in other provinces it was the small firm which contributed most jobs in Ontario. Figure 3 shows the service sector was responsible for 40% of jobs created in Ontario from 1974 to 1982. This compares to 19% in manufacturing, 19% in trade and -4% in construction.[7]

Figure 3
Percentage of Net Employment
Change by Industry
Ontario 1974-1982



Source: ORIE-Birch, 1984

The service sector in Ontario has been a major source of economic growth:

- Over the past decade, service producing industries in Ontario have increased their share of net domestic product from just over 50% to 62% in 1983.

- Small service sector firms in Ontario account for 17% of all small business sales. Small manufacturers account for only 13% of small business sales.

- Capital expenditures in the manufacturing sector grew from $3.0 billion in 1976 to $3.8 billion in 1983 (27%). This compares to growth from $1.8 million in 1976 to $3.6 billion in 1983 in the trade, finance and commercial services sector (100%).

- M.I.T. has monitored new business registrations in Ontario and found that approximately 69% were in the service sector compared with 23% in retail and only 8% in manufacturing.

The service sector has had the greatest positive impact on job creation in the Province. Table 4 demonstrates that from 1976 to 1985 employment in the service sector rose by over 380,000 jobs representing an increase of 39%. Service was followed by trade at 24%. These sectors exceeded job growth in manufacturing by a broad margin. While the job creation performance of sectors emerging from recession in 1984-85 is mixed, trade and services continue to compare favourably with manufacturing.

TABLE 4

EMPLOYMENT GROWTH BY INDUSTRY
ONTARIO 1976 - 1985

Industry	Employment (000's) 1976	Employment (000's) 1985[1]	Percentage Change 1976 to 1985
Primary	169	174	2.9
Manufacturing	909	975	7.3
Construction	230	224	2.6
Transportation, Communications, and Other Utilities	271	306	12.9
Trade	610	756	23.9
Finance, Insurance, and Real Estate	217	245	12.9
Service	973	1,354	39.2
Public Administration	264	287	8.7
Total	3,643	4,321	18.6

[1] April 1985

Source: Statistics Canada

As shown in Table 5, in the manufacturing sector an estimated 279,000 jobs were created by births or start-ups from 1976 to April 1985. At the same time the sector lost an estimated 260,000 jobs due to business closings for a net gain of 19,000. In the service sector by comparison, start-ups were responsible for creating an estimated 460,000 new jobs while losing 185,000 due to business closings. The net gain of 275,000 considering births and deaths alone, is almost fifteen times the experience in the manufacturing sector.

TABLE 5

JOB CREATION BY SECTOR, ONTARIO 1976-1985

	Manufacturing	Service
Births	279,000	460,000
Deaths	(260,000)	(185,000)
Expansion	161,000	186,000
Contraction	(114,000)	(80,000)
Net Job Creation	66,000	381,000

Source: MIT Estimate, based on Statistics Canada Labour Force Data and DRIE-Birch findings, 1985.

The service sector created 207,000 new jobs for men during the 1976 to 1983 period accounting for 121% of the net increase in male employment in Ontario. This compares to a real loss of 1.5% of male positions in manufacturing. The service sector accounted for 57% of the net increase in jobs for women from 1976 to 1983. While the percentage change was 35.9% for women in this period in service, growth of 14.8% was experienced in manufacturing.[8]

Increasingly, new women entrepreneurs have opened service firms in the Province. In a 1984 MIT survey of new business registrants, 60% of female respondents indicated they were registering a service firm compared to 11% manufacturing and 30% retail.

If the Ontario government wishes to provide equity financing through SBDC to the fastest growing parts of the economy, and to support the Government's commitment to encouraging an active role for women in the economy, extension of SBDC eligibility to selected business services firms is an appropriate initiative. It would underpin a sector dominated by smaller, younger firms which have demonstrated positive job creation.

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8 Statistics Canada, Labour Force Statistics. See Appendix 2, Table 3, for a detailed comparison of male and female employment growth.

III. CAPITAL NEEDS OF SMALL BUSINESSES

There is general agreement that small firms fail as a result of under-capitalization. Evidence from various sources indicates that the capitalization of new firms is mainly from personal assets often amounting to less than $5,000. If additional capital is available, it is most likely sourced from friends and relatives. Venture capitalists are rarely sought out. Short-term requirements are funded from conventional private sector lenders or from government programs. What results, if a firm continues to operate, is a reliance on debt financing secured by business and personal assets. The typical small firm begins life with an unhealthy debt/equity ratio which is difficult to overcome.

The need to infuse equity into small firms has been accepted by framers of public policy and by business owners. The latter have increasingly demonstrated a willingness to exchange part ownership of a business for equity in order to insure continuation. A viable partly-owned business is preferable to a wholly-owned bankrupt firm. Public policy in Canada has, for its part, deemphasized debt financing in favour of supportive tax regimes which reward equity placements by investors. Across Canada, provinces like British Columbia, Alberta, Saskatchewan, and P.E.I. have established small business equity or development corporations. These mirror the initiative undertaken in Ontario when it established the Small Business Development Corporation program.

The SBDC program has been a major source of equity financing and is a significant component of organized venture capital. SBDC has aided various sizes of firms by placing risk-oriented equity investments in small businesses. The Clarkson Gordon report as well as recent work by the Economic Council of Canada has explained small business equity requirements in terms of structure, cyclical trends and marketplace changes.

The structure of small firms' balance sheets is dominated by short term liabilities as compared to large firms. While the smallest firms have 55% liabilities and 45% equity, large firms have 41% liabilities and 59% equity. This distortion is compounded by the mix of short and long term debt. As demonstrated in Table 6, the smallest firms carry 41% short-term and about 14% long-term debt whereas larger corporations have only 19% of their financing in short-term debt.

TABLE 6

DISTRIBUTION OF CORPORATE FINANCING, BY CATEGORY OF INSTRUMENT AND SIZE OF FIRM ASSETS CANADA 1981

	Assets					
	$249,000 and less	From $250,000 to $999,999	From $1,000,000 to $4,999,999	From $5,000,000 to $9,999,999	From $10,000,000 to $24,999,999	$25,000,000 and over
Liabilities	54.8	54.5	56.6	54.0	48.2	41.1
Short Term	41.2	37.8	42.0	39.0	33.4	19.3
Long Term.	13.6	16.7	14.6	15.0	14.8	21.8
Equity	45.2	45.5	43.4	46.0	51.8	58.9
Shareholders Equity	44.8	44.7	41.4	43.1	48.2	51.9
Deferred Taxes	0.4	0.8	2.0	2.9	3.6	7.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Council of Canada

Government efforts should therefore be concentrated on improving the capacity of smaller firms to attract equity.

The placement of greater amounts of equity in small firms will provide the start-up with the capacity to survive almost inevitable losses experienced during the first five years of operation. Table 7 dramatizes the extent of profit volatility among various sizes of firms. Almost 60% of the smallest firms fall outside normal rates of return on assets of 0-16% whereas only 23% of large firms do.

TABLE 7

DISTRIBUTION OF INDEPENDENT FIRMS IN PRIMARY AND SECONDARY SECTORS, BY AFTER-TAX RATE OF RETURN OF ASSETS AND SIZE OF ASSETS, CANADA 1977

	Assets					
Rate of Return	$249,000 and less	From $250,000 to $999,999	From $1,000,000 to $4,999,999	From $5,000,000 to $9,999,999	From $10,000,000 to $24,999,999	$25,000,000 and over
Negative	28.2	17.4	14.3	13.2	8.8	9.2
0 - 8%	18.7	28.9	30.1	34.8	33.5	39.1
8 - 16%	22.8	28.9	39.0	37.1	38.0	37.4
Greater than 16%	30.3	24.8	16.5	15.1	19.7	14.4
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

SourceL Estimates by the Economic Council of Canada based on unpublished data from Statistics Canada.

Since 1980 there has been a steady deterioration in profits and an inexorable climb in both the levels and cost of debt. The interest burden (calculated as interest/profits before tax) has grown for both large and small firms. Among large firms, interest burden increased from 20% in 1979 to 42% in the first quarter of 1984. Among small and medium sized firms, interest burden increased from 35% in 1979 to 62% some five years later. Their interest burden over the period 1979 to 1984 was about fifty per cent more than that of large firms. At the same time they experienced profits one-fifth as great as large firms and profit margins of one-third that for large firms. The interest burden and profit margins faced by small firms compare unfavourably to the universe of Canadian industrial corporations.[9]

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9 Statistics Canada, Corporation and Financial Statistics.

IV. THE SBDC PROGRAM AND INVESTMENT IN BUSINESS SERVICES

The scope of eligibility under Ontario's SBDC program is now restricted to manufacturing, tourism, book publishing and research and development. Current SBDC rules are based on the assumption that manufacturers are largely at the heart of the wealth generation process. Successful manufacturers, however, do not stand alone. They exist within a network of service and trade companies on whom they depend for, among other things, design innovation, delivery of goods and services and market intelligence. If this network is capital-starved manufacturers will suffer as well.

The Clarkson Gordon study recommended expanding SBDC investments to young entrepreneurs, high technology businesses and Northern Ontario. With respect to young people, the study argues "they are likely to start businesses in the service sector. Therefore, if the SBDC program is to be targetted to this group, some expansion of the definition of eligible small business should be considered. <u>An appropriate expansion might include the whole service sector other than financial or professional services</u>".[10]

Recognizing the environment of fiscal restraint and the need to keep demands on the SBDC program manageable, MIT has looked for ways of targeting the program as effectively as possible. In this section a rationale is developed, based on the performance of **business service** firms, for a workable expansion of SBDC eligibility.

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10 Clarkson Gordon, <u>op. cit.</u>, p. 69, Underlining added.

Inclusion of business services under SBDC would place equity in more firms and create more jobs. There are about 60,000 small service sector businesses in Ontario. Business services, such as computer services, advertising services, engineering and scientific services, make up 25% of that number or 15,000 firms.[11]

The Clarkson Gordon study estimated that the cost to the Province for each job created as a result of SBDC incentives at $14,000. Thus, the current annual allocation of $25 million to the program is estimated to assist directly the creation of about 1,800 jobs. If service sector businesses were eligible for SBDC incentives, the job creation returns would likely be greater, due to the relatively more dynamic performance of these firms. It is estimated that directly assisted job creation under SBDC would increase from the present 1,800 to over 5,000 jobs if the existing allocation was wholly taken up by service sector investments.

The service sector in Canada experienced a net change in jobs of 51% from 1974 to 1982. Over the same time period business services firms experienced a net change in jobs of 159%. Of this total, the strongest job performers were business services firms employing under 50 or over 500 employees. In the case of the smaller firms, the net employment growth in firms with less than 20 employees was 368%. Firms with 20 to 50 employees had a 236% employment growth. With limited resources, it would make sense for the Ontario government to concentrate new SBDC investment on

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11 The business services industries as defined by the Standard Industrial Classification (SIC) codes, excluding the professional services of lawyers, accountants, architects and management consultants, are shown in Appendix 4.

business services firms which have demonstrated they are overwhelmingly the strongest performers in the service sector. One would expect business services firms to yield new jobs and business formations at a rate three times more rapid than the service sector as a whole.[12]

SBDC has provided an incentive to investors in small businesses. As the Clarkson Gordon study noted, "small business continues to need government assistance, and there is a need for such assistance to come in the form of equity, which is not provided by most other government programs. Providing the incentive to investors rather than funding direct government investment in small business is efficient and effective". [13]

The goal for government should be to provide assistance to firms which on average have less than $1 million in gross sales and whose capital requirements fall below $250,000. This range is the most difficult of all to service from the point of view of institutional capital. Primarily because the costs of investigation and supervision of an investment are both high and fixed, institutions as well as venture capitalists find it uneconomic to invest small amounts. The typical venture capital investment approaches $500,000.

The SBDC program places smaller investments than do conventional venture capitalists. The average SBDC placement is about $185,000, an amount more appropriate for small firms but still larger than the requirements of many

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12 A range of program results has been estimated for various levels of take up. The analysis is found in Appendix 3.

13 Clarkson Gordon, op cit, pp. 61-62.

new and younger firms. The 1984 revisions to the SBDC program recognized that the program should be targeted to start-up firms.

The Ministry of Revenue's experience suggests that the smallest investments attainable through the SBDC program are in the range of $100,000. To facilitate the placement of investments, the Ministry of Revenue provides a Match-Up Service to bring together appropriate SBDC investors and small business owners seeking equity investment. This activity, currently operating on a modest scale, is providing a valuable service to Ontario entrepreneurs. Expanding this initiative, with the specific objective of placing a larger volume of smaller investments, would complement expansion of SBDC eligibility to business services. It would also enhance the SBDC program's ability to target start-ups and younger firms.

V. CONCLUSIONS

- SBDC is a very effective program, well-liked by business and successful in stimulating incremental investment in small business.

- SBDC has assisted in placement of investments averaging $185,000 in the designated areas of manufacturing, research and development, tourism and book publishing.

- New business formation, expansion, and job creation in service businesses have outpaced the performance of goods-producing industries by a factor of two to three times.

- Because the service sector is so dynamic, the expected job creation benefits of improved access to equity through extension of SBDC to small service sector firms would be 2.8 times greater than the existing combination of manufacturing and other eligible businesses. The greatest job creation benefits of all will come from the business services area (See Appendix 3).

- Service sector performance has also exceeded manufacturing in share of output and capital expenditure over the past decade.

- There is a persistent deficiency in access to equity capital among small firms, particularly for start-ups, young firms and companies not yet ready for public issue of shares.

- The Ministry of Revenue's matching of SBDC investors with small business investment opportunities is a valuable service to Ontario entrepreneurs.

VI. RECOMMENDATIONS

1. That top priority for extension of eligibility under Ontario's SBDC program be given to Ontario's 15,000 business services firms (See Appendix 4).

2. That the Ministry of Revenue expand its existing Match-up Service to introduce appropriate SBDC investors and small business owners and emphasize smaller placements of equity.

APPENDIX 1

CONSULTATION ON ACCESS TO EQUITY FINANCING FOR SMALL BUSINESS

JANUARY 31, 1985

<u>APPENDIX 1</u>

MINISTRY OF INDUSTRY AND TRADE

CONSULTATION ON ACCESS TO
EQUITY FINANCING FOR SMALL BUSINESS
JANUARY 31, 1985

EXCERPT FROM MINUTES RE:
SMALL BUSINESS DEVELOPMENT CORPORATIONS

- Friedman focused the discussion on SBDC's. He asked participants how these should be dealt with; should the base expand and should a vehicle like this be recommended for the federal level.

- Hale emphasized the disastrous impact which would result on the business climate if the SBDC's were to run short of funds. He said the SBDC is doing well and meets most of the criteria, however, he complained about the move of the SBDC to Oshawa from Toronto, claiming that it was costly to clients to deal in Oshawa and suggested moving it back to Toronto.

- Sweeting asked if participants thought the SBDC's funding to be better than other types of funding. Hale replied that it is impossible for the SBDC to be all things to all people. One vehicle should not serve all clients at once. Whyte added that the SBDC is typically not an arms-length mechanism and does not consider it to be a panacea.

- Sweeting said a review is presently under way for including start-ups and other possible target areas in the eligibility clause for SBDC funds. He expressed concern regarding targeting in that it will probably result in conflicts within the SBDC's. Girvin advocated that hitting target groups is the priority.

- Selby suggested providing funds in smaller amounts through the SBDC's for start-ups. Friedman commented that the SBDC's are not presently serving potential clients under the $100,000 mark. Johnston-Lavigueur said there are funds smaller than this given by the SBDC in certain regions to which Girvin remarked that generally the start-up client is not strongly addressed by the SBDC's.

APPENDIX 1

- Whyte argued that what amounts to a 30% grant currently awarded by SBDC's permits a rape of the tax system and if funding is brought down to the $50,000 level more people will take advantage of it. Hale advocated interest free loans to match clients investment in R & D be given by the SBDC's as is done in Nova Scotia.

- Selby suggested including retailers in the base for SBDC funds. He said we cannot prejudge what is good for Ontario, therefore, the base of the SBDC's should be broadened. Rosen agreed that the base should be expanded. He emphasized that manufacturers do not necessarily have or hire more employees than do retailers. This is particularly relevant if employment is a concern. Friedman explained that employment was not an explicit concern, but is definitely an implicit concern of the Ministry of Industry and Trade.

- Johnston-Lavigueur advised not to tie management assistance to financial assistance. Smyth opposed this view recognizing that investors will ultimately become involved in the business.

- Friedman summarized the main points made during the meeting. It was agreed that two measures deserved immediate support and should be implemented in the 1985 Budgets of the Federal and Ontario governments.

  SBDC

  - Considerable support for expanding the eligibility clause.
  - To broaden the base, targets must be defined.
  - The amount of funding needed is in the $50,000 range.

  RRSP

  - The majority supported the use of self-directed RRSP's for funding start-ups and relatively small companies.

Further, Friedman commented:

  Subchapter S

  - The consensus of the group is to favour the RRSP proposal over this one.
  - Too complex.
  - Pitfalls in approaching the federal government.

  U.I. Entitlement and Non-Taxation of Severance Pay

APPENDIX 1

Rollover of Capital Gains

- No consensus on this issue.

Corporate Tax Holiday

- Mixed views on this issue did not permit a consensus to be reached.

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APPENDIX 2

SUPPLEMENTARY TABLES

T A B L E 1

COMPONENTS OF NET EMPLOYMENT CHANGE BY INDUSTRY

CANADA 1974 - 1982

Sector	Births	Deaths	Expansion	Contraction	Net Change
Agriculture	17,936	(8,095)	9,576	(4,758)	14,659
Forestry	11,927	(8,034)	5,433	(4,513)	4,813
Fishing	1,408	(459)	701	(660)	990
Mines	71,989	(30,208)	18,472	(10,258)	49,995
Manufacturing	475,098	(442,538)	272,960	(198,419)	112,101
Construction	178,580	(125,410)	78,680	(75,860)	55,982
Transportation	138,966	(64,548)	89,100	(52,330)	111,188
Trade	495,294	(340,729)	211,928	(126,657)	239,833
Finance	155,489	(64,491)	56,102	(34,773)	112,327
Services	506,293	(203,666)	205,427	(88,350)	419,704
Totals	2,052,977	(1,288,178)	948,379	(591,586)	1,121,592

Source: DRIE, "Job Creation Process in Canada", undertaken with assistance by David Birch, October 1984, p.16

T A B L E 2

PERCENTAGE CHANGE IN EMPLOYMENT
SELECTED SECTORS IN SERVICES AND MANUFACTURING
CANADA 1974 - 1982

	Number of Employees						
	0-19	20-49	50-99	100-199	200-499	500+	Total
Services							
			(Per Cent)				
Education	152.1	57.3	18.5	49.8	37.2	10.4	18.2
Health	220.4	66.2	80.5	29.7	33.5	37.5	44.0
Social	243.4	141.3	53.0	37.7	194.7	51.2	90.2
Business	368.2	236.7	70.8	112.5	20.8	257.7	159.4
Professional	139.3	58.9	39.0	40.5	35.2	130.6	87.3
Totals	75.6	48.9	42.3	35.3	21.1	42.3	51.0
Manufacturing							
Rubber	88.0	45.3	42.4	(25.2)	5.0	(14.8)	3.9
Paper	69.4	24.1	0.7	(7.2)	(5.6)	13.9	11.7
Primary metal	80.5	15.5	(0.4)	22.2	8.9	21.9	20.9
Machinery	94.2	23.6	3.2	(18.3)	0.5	13.3	14.3
Electric	98.6	45.6	(6.1)	(22.1)	(33.5)	5.9	3.0
Totals	57.4	12.6	(8.9)	(14.5)	(14.4)	12.8	7.3

Source: DRIE, "Job Creation Process in Canada", undertaken with assistance by David Birch, October 1984, pp. 18, 25.

T A B L E 3

**EMPLOYMENT GROWTH BY SECTOR
ONTARIO 1976 - 1983**

	Employment (000's)				Percent Change	
	Men		Women		Men	Women
Sector	1976	1983	1976	1983	1976-1983	1976-1983
Primary	136	134	30	50	(1.5)	66.7
Manufacturing	665	655	244	280	(1.5)	14.8
Construction	214	183	17	19	(14.5)	11.8
Transportation, Communications, and Other Utilities	216	214	55	75	(0.9)	36.4
Trade	350	371	260	307	6.0	18.1
Finance, Insurance, and Real Estate	90	102	127	147	13.3	15.7
Service	395	503	577	784	27.3	35.9
Public Administration	173	164	90	105	(5.2)	16.7
Total	2,239	2,328	1,403	1,768	4.0	26.0

Source: Statistics Canada, Labour Force Data.

TABLE 4

FINANCIAL CHARACTERISTICS OF INDUSTRIAL CORPORATIONS
CANADA 1979 - 1984

	1979	1980	1981	1982	1983	1984.1
Index of Gross National Product						
(1977 - 1.000)	1.176	1.307	1.446	1.591	1.683	1.723
All Companies						
Sales of SME's/total sales	40.4	39.7	37.5	36.2	36.6	36.5
Small and Medium Companies						
Sales	137,287	134,282	134,247	116,101	119,198	125,925
Profits	5,872	5,154	4,880	2,824	3,273	3,301
Interest paid	2,074	2,321	3,097	2,889	2,231	2,059
Profit margin	4.3	3.8	3.6	2.4	2.7	2.6
Interest burden	35.3	45.0	63.5	102.3	68.2	62.4
Large Companies						
Sales	202,116	203,741	224,165	204,452	206,611	219,403
Profits	19,725	19,718	16,642	9,422	13,541	15,863
Interest paid	4,113	4,888	7,433	8,378	6,737	6,723
Profit margin	9.8	9.7	7.4	4.6	6.6	7.2
Interest burden	20.9	24.8	44.7	88.9	49.8	42.4
All Companies						
Sales	339,402	338,023	358,411	320,553	325,809	345,328
Profits	25,598	24,871	21,522	12,246	16,814	19,164
Interest paid	6,187	7,209	10,530	11,268	8,968	8,782
Profit margin	7.5	7.4	6.0	3.8	5.2	5.5
Interest burden	24.2	29.0	48.9	92.0	53.3	45.8

Note: Companies are divided into those with assets more or less than $10 million. Profit margin is profits/sales; interest burden is interest paid/profits. Sales, profits and interest paid are in millions of dollars.

Source: Statistics Canada, Corporation Financial Statistics.

APPENDIX 3

JOB CREATION IMPACT OF EXTENDED SBDC ELIGIBILITY

APPENDIX 3

JOB CREATION IMPACT OF EXTENDED SBDC ELIGIBILITY

1. The present SBDC program, according to the Clarkson Gordon study, assists directly in the creation of one job per $14,000 cost to the Province.

2. Job creation in small service sector firms is estimated as follows, assuming the same $14,000 cost to the Province.

SBDC incentive	$14,000
Related investment (incentive is 30% of investment)	46,667
Related sales (based on Dun and Bradstreet ratios)	84,000
Direct jobs (at $30,000 sales per job)	2.8

3. Job creation in the small service sector is thus estimated to be 2.8 times greater than under the present SBDC program.

4. If the current SBDC allocation of $25.0 million is assisting the creation of 1,800 jobs, the same funding wholly devoted to small service firms would yield 5,000 jobs.

5. The job creation impact of extended eligibility has been calculated on the above assumptions for a range of take up levels. The results are shown in the following table.

APPENDIX 3

RANGE OF SBDC PROGRAM IMPACT FOR EXISTING $25.0 MILLION ALLOCATION

Percentage of SBDC Funds in Service Sector Investments	Firms Assisted	Jobs Created
Nil - Status Quo	192	1,786
15%	216	2,268
25%	232	2,590
35%	248	2,911
50%	272	3,393
100%	352	5,009

Source: MIT Estimates, 1985.

APPENDIX 4

STANDARD INDUSTRIAL CLASSIFICATION
SERVICES TO BUSINESS MANAGEMENT

APPENDIX 4

STANDARD INDUSTRIAL CLASSIFICATION

SERVICES TO BUSINESS MANAGEMENT

SIC Code 851

Employment Agencies and Personnel Suppliers

SIC Code 853

Computer Services

SIC Code 855

Security and Investigation Services

SIC Code 862

Advertising Services

SIC Code 864

Engineering and Scientific Services

SIC Code 869

Miscellaneous Services to Business Management